Louisiana Law Review

Volume 25 | Number 2
Symposium Issue: The Work of the Louisiana Appellate Courts for the 1963-1964 Term
February 1965

Private Law: Mineral Rights

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fixed rule that a timely suit against one tortfeasor interrupts prescription for other joint tortfeasors.[29] Thus, a timely suit against a doctor preserved the effectiveness of the cause of action; and, when it was later alleged that the hospital was a joint tortfeasor, the hospital's insurer could not be released on account of prescription even though the hospital might plead the personal defense of charitable immunity.

MINERAL RIGHTS

*George W. Hardy, III**

MINERAL LEASES

Obligation To Protect Against Drainage

One of the most significant decisions rendered during the 1963-64 term was *Breaux v. Pan American Petroleum Corp.*,[1] in which plaintiff sought to recover damages for his lessee's failure to prevent drainage of oil and gas from beneath plaintiff's premises. The essential allegations of plaintiff's petition were that: plaintiff owned the land in question; defendant held a mineral lease on the land in question granted by plaintiff; defendant also held a lease on adjoining property; defendant had drilled a well within eighty feet of plaintiff's property line; approximately half of the oil drained from that well was drained from beneath plaintiff's property; defendant had been previously placed in default; and, therefore, plaintiff was entitled to damages equal to one-half of the one-eighth royalty from the draining well. The trial judge sustained an exception of no cause of action, and plaintiff appealed.

Despite the fact that the Third Circuit Court of Appeal sustained the judgment of the lower court, this decision is full of meaning for both lessors and lessees in Louisiana. First, the court rather clearly sustained defendant's exception of no cause of action on the ground that plaintiff had not made proper allegations. The opinion strongly asserts the existence of a

29. LA. CIVIL CODE arts. 2097, 3552 (1870).

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1. 163 So. 2d 406 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 581, 165 So. 2d 481.

cause of action for damages resulting from drainage of minerals from beneath a leased tract in Louisiana, a matter which had formerly been in considerable doubt.[2] The existence of such a cause of action was considered to be in addition to the remedy of cancellation which had been previously accepted as appropriate in situations of this kind.[3]

The court indicated that the elements of a cause of action for damages for drainage under the implied obligation to protect the leased premises include: the existence of substantial drainage; proof with some degree of certainty of the quantity of oil or gas that would have been produced from an offset well; the value of lessor's share of such minerals; and proof that it would have been economically feasible for the lessor to drill an offset well. In adopting these elements as a possible cause of action for damages for drainage in Louisana, the Third Circuit adhered to the majority rule.[4] The measure of damages under this rule is the amount of royalty which would be due if the offset well had been drilled at the proper time and had produced as proven by the lessor. The minority view accepts as a proper measure of damages the lessor's royalty share on drainage which he proves to have taken place from beneath his property because of the lessee's failure to drill a profitable offset well at the proper time.[5]

Two other features of this decision are of prime significance. The first is presented by the fact that defendant lessee in the *Breaux* case was also lessee of the adjoining tract on which the draining well was drilled. Plaintiff sought to have the court sustain the view that because defendant was lessee of both tracts a greater right existed in plaintiff's favor to recover for the drainage caused directly by his own lessee.[6] The court, how-

2. See, *e.g.* Billeaud Planters, Inc. v. Union Oil Co., 245 F.2d 14 (5th Cir. 1957); McCoy v. State Line Oil & Gas Co., 175 La. 231, 143 So. 58 (1932).

3. Swope v. Holmes, 169 La. 17, 124 So. 131 (1929).

4. Hartman Ranch Co. v. Associated Oil Co., 10 Cal. 2d 232, 73 P.2d 1163 (1937); North American Petroleum Co. v. Knight, 321 P. 2d 964 (Okla. 1958); Deep Rock Oil Co. v. Bilby, 199 Okla. 430, 186 P. 2d 823 (1947); Junction Oil & Gas Co. v. Pratt, 99 Okla. 14, 225 Pac. 717 (1924); Texas Pacific Coal and Oil Co. v. Barker, 117 Texas 418, 6 S.W. 2d 1031 (1928); Texas Co. v. Ramsower, 7 S.W. 2d 872, 10 S.W. 2d 537 (Tex. Com. App. 1928); Sinclair Oil & Gas Co. v. Bryan, 291 S.W. 692 (Tex. Civ. App. 1927), *error ref'd*; 5 WILLIAMS & MEYERS, OIL & GAS LAW §§ 822, 825.2 (1964).

5. Olsen v. Sinclair Oil & Gas Co., 212 F.Supp. 332 (D. Wyo. 1963); Blair v. Clear Creek Oil & Gas Co., 148 Ark. 301, 230 S.W. 286 (1921); Kleppner v. Lemon, 198 Pa. 581, 48 Atl. 483 (1901); 5 WILLIAMS & MEYERS, OIL & GAS LAW § 825.2 (1964).

6. Several jurisdictions have postulated that the liability of the lessee is greater

ever, rejected this view, holding that the fact that defendant was lessee of both tracts made no difference whatsoever to plaintiff's substantive rights.

The realities of this situation are underscored by comparison with the normal drainage situation. If *A* and *B* are lessees of adjoining tracts and *A* causes drainage from beneath *B's* lease, the natural competitive situation thus created gives *B's* lessor at least reasonable assurance that *B* will be spurred to protect his own interest as lessee, and therefore that of his lessor as well. However, in the factual situation presented by the *Breaux* case, this competitive urge is not present. No matter who participates in the production from a given well, and no matter what lease tracts are drained by it, the lessee who holds the leases on two adjoining tracts has to pay only a specified royalty on production from any given well. Therefore, if two leases can effectively be drained by a single well, common sense dictates that the law should not present to a lessee an opportunity to save on drilling costs without at least some sanction to assure proper protection to both lessors.

The second additional feature of the *Breaux* decision is the court's indication of the possibility of some protection for the lessor whose property is drained by his own lessee. In dictum, the opinion strongly intimates the existence of a cause of action for a lessee's failure to protect leased premises from drainage by seeking the formation of an appropriate production unit.[7] The measure of damages in such cases would apparently be the

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if it appears that his operations cause the drainage which is the source of the lessor's complaint. Olsen v. Sinclair Oil & Gas Co., 212 F. Supp. 332 (D. Wyo. 1963); Geary v. Adams Oil & Gas Co., 31 F. Supp. 830 (E.D. Ill. 1940); Blair v. Clear Creek Oil & Gas Co., 148 Ark. 301, 230 S.W. 286 (1921); Hartman Ranch Co. v. Associated Oil Co., 10 Cal. 2d 232, 73 Pac. 2d 1163 (1937); Hughes v. Busseyville Oil & Gas Co., 180 Ky. 545, 203 S.W. 515 (1918) (dictum); Central Kentucky Natural Gas Co. v. Williams, 249 Ky. 242, 60 S.W. 2d 580 (1933) (dictum); Phillips Petroleum Co. v. Millette, 221 Miss. 1, 72 So. 2d 176, 74 So. 2d 731 (dissent) (1954); Millette v. Phillips Petroleum Co., 209 Miss. 687, 48 So. 2d 344 (1950); Dillard v. United Fuel Gas Co., 114 W. Va. 684, 173 S.E. 573 (1934); Trimble v. Hope Natural Gas Co., 113 W. Va. 839, 169 S.E. 529 (1933) (dictum); Phillips Petroleum Co. v. Millette, 221 Miss. 1, 72 So. 2d 176, S.E. 366 (1932); 5 WILLIAMS & MEYERS, OIL & GAS LAW § 824 (1964).

7. "It is conceivable, although it is not necessary for determination to that effect be made in this case, that the lessor would be entitled to recover damages by alleging and proving that the lessee could have created a pooling unit, thus enabling the landowner to participate in the production from the draining well, but that he failed to do so. But, even on that ground the lessor must establish the value of the minerals which he would have received if such a unit had been timely formed." Breaux v. Pan American Petroleum Corp., 163 So. 2d 406, 415-16 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 581, 165 So. 2d 481.

proven participation of the lessor in a properly formed unit, certainly a lighter burden than that facing the lessor in an ordinary drainage case. This dictum is a sound approach to the problem of forcing a lessee to protect his lessor when drilling of an offset well might not pay out but drainage is nevertheless in significant amounts. This approach is also in keeping with the prudent operator standard. If a lessor can prove that a reasonably prudent operator, mindful of his obligations to both lessors, would have sought the establishment of a production unit, whether by declaration, contractual agreement, or conservation order, he should be entitled to recover the royalty representing the calculated participation of his property if the unit had been formed at the proper time.[8] This concept is also harmonious with the recognized duty of the lessee to deal fairly with his lessor's interest and does not thwart the lessee's legitimate interest in minimizing drilling costs.

Utilization of the concept of a duty to unitize accomplishes protection for the lessor which has been afforded in other jurisdictions only by perversion of the majority rule requiring proof of substantial drainage, the profitability of an offset well, and the royalty due if an offset well had been drilled at the appropriate time.[9] Other jurisdictions, reacting instinctively to the opportunity for unfair dealing presented by a lessee's conduct in draining an adjoining tract which he also has under lease, have sometimes dispensed with the requirement of proving that an offset well would pay out. While this punitive alteration of

8. In connection with and perhaps in opposition to, the suggestion of the court that a lessee may be obligated to form a drilling and production unit, it should be pointed out that under R.S. 30:6F (1950) "any interested person" may provoke a conservation hearing. This phrase would include a lessor. Therefore, a lessor has the right to provoke a conservation hearing to establish a unit which will protect his interest. It might well be that the existence of this right could be utilized to negate any obligation of the lessee to form a unit in protection of the lease premises. However, it has been suggested by noted authorities, with which the writer agrees, that because of the superior position of the lessee in terms of technical capability and economic resources, the lessee should operate under a duty to represent the lessor's interest in situations of this kind. This is particularly true, as noted later in the body of this mansucript, when the lessee causes the drainage and, because of his legitimate interest in minimizing drilling costs, might be tempted to place his own self-interest before that of his lessor. See, *e.g.* Merrill, *Implied Covenants, Conservation and Unitization*, 2 OKLA. L. REV. 469 (1949).

9. Geary v. Adams Oil & Gas Co., 31 F. Supp. 830 (E. D. Ill. 1940); Bush Oil Co. v. Beverly-Lincoln Land Co., 69 Cal. App. 2d 246, 158 P.2d 754 (1945); Phillips Petroleum Co. v. Millette, 221 Miss. 1, 72 So. 2d 176, 74 So. 2d 731 (dissent) (1954); Adkins v. Huntington Development & Gas Co., 113 W. Va. 490, 168 S.E. 366 (1932). For a full discussion of this problem see 5 WILLIAMS & MEYERS, OIL & GAS LAW § 824 (1964).

substantive rights does offer a sanction which restricts lessee's conduct in these circumstances, the approach conflicts somewhat with the prudent operator rule. Despite the fact that an operator has adjoining tracts under lease, it seems unfair to require of him a level of conduct beyond that of the prudent operator.[10] If a well would not be profitable, why should he be required to pay damages for having failed to drill merely because he has both tracts under lease? The suggestion of a duty to unitize, on the other hand, does provide an outlet. Although a prudent operator might not drill an uneconomic well, it is not at all unreasonable to expect that a prudent operator would unitize. The measure of damages proposed by the Third Circuit opinion would relieve the lessor of the need for proving profitability of an offset well, measuring damages instead by a calculated participation in the unit which should have been formed. Therefore, in those cases in which lessor cannot prove profitability of an offset well, he will more often than not be protected if he can prove actual drainage in an amount which would have warranted formation of a production unit.

One further matter concerning the suggested duty to unitize should be discussed. What are the standards by which one determines whether a prudent operator would form a unit? Certainly, the normal technical standards concerning the drainage radius and production characteristics of a given well should be applied. However, a lessee might be led, considering the extremity of a lawsuit, to contend that even though a drilling unit might be formed to include a part of the complaining lessor's property, the reasonably prudent operator would not have formed such a unit or sought its formation by compulsory order as he was the lessee of both tracts and needed no such order. Indeed, there is some basis for this contention in the Louisiana jurisprudence. However, the concept of the lessee's duty of fair dealing should overcome any such argument. One of the criteria by which the conduct of a reasonably prudent operator should be judged is that such an operator would comply with his obligation to deal fairly with the interests of all persons from whom he has leases and to protect their interests as well as his own. This expectation is particularly appropriate in a situation in which the operator has a primary interest in minimizing his own expenses, a consideration which might lead him to give his own interest a paramount position as compared

with that of the lessor whose land he is draining if unitization were not available.

It is to be noted that the *Breaux* case does not treat the problem of default in drainage cases. A strong argument can be made that default should not be required, except possibly by express provisions of the lease, even if the drainage is caused by one other than the lessee of the drained tract.[11] However, there is a substantial basis for dispensing with the default requirement if the operator is lessee of both tracts. The act of draining two leases by means of one well is not merely a passive failure to comply with an obligation to protect the drained lease, it is conduct clearly inconsistent with that obligation if it occurs in the face of actual or constructive knowledge of the drainage.[12] Thus, the lessee's action should properly be viewed as an active

10. It might be here noted that Judge Tate suggested in dissenting from Breaux v. Pan American Petroleum Corp., 163 So. 2d 406 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 581, 165 So. 2d 481, that certain of the elements of the cause of action for damages as stated by the majority should be made matters of defense to be asserted and proved by the lessee. These include: whether drainage has actually occurred or could have been prevented by offset drilling or conservation remedies. Further, it has been suggested in 5 WILLIAM & MEYERS, OIL & GAS LAW § 824.2 (1964), that because of the possibility of unfair dealing in the situation where the lessee owns both the drained and the draining lease, the burden of going forward with evidence and the burden of persuasion as to profitability of the offset well, should rest on the lessee. Thus, the plaintiff's case would consist of (1) proof of substantial drainage; (2) proof that lessee's operations were the cause of the drainage; and (3) the amount of the damages.

11. The damages caused by drainage should properly be viewed as compensatory rather than moratory damages for mere delay in performance. It has been urged that no formal default should be required as a prerequisite to an action for compensatory damages. See Smith, *The Cloudy Concept of Default*, 12 ANN. INST. ON MINERAL LAW, to be published in 1965. The remainder of the discussion in the text of this article, however, is based upon the assumption that courts will continue to apply the active-passive breach dichotomy, requiring a formal putting in default as a prerequisite to recovery of damages for passive breach of contract and dispensing with such requirement if the breach can be characterized as active.

An additional argument that no default should be required as a prerequisite to recovery of damages for failure to protect leased premises against drainage may be based upon LA. CIVIL CODE art. 1933 (1) (1870), under which damages are due from the time of the breach if the obligation in question is one which may be performed only within a certain time or under certain circumstances which no longer exist. Clearly one may not protect against drainage which has already occurred. Therefore, it would seem logical to hold that no default would be necessary when recovery for past drainage is being sought. As to future drainage, the lessee might protect himself in several ways in response to a suit for damages: he would be able to tender performance of his obligation to protect against drainage; he might also defend on the ground that further efforts at protection would be fruitless as future drainage would be in insignificant amounts.

12. LA. CIVIL CODE art. 1931 (1870): "A contract may be violated, either actively by doing something inconsistent with the obligation it has proposed or passively by not doing what was covenanted to be done, or not doing it at the time, or in the manner stipulated or implied from the nature of the contract."

breach of his lease contract. The writer holds this view despite the contrary opinion by the United States Court of Appeals for the Fifth Circuit.[13]

Categorization of the lessee's conduct as an active breach of contract might accomplish two laudable ends. First, it would dispense with the requirement of default as a means of fixing the time from which damages should be computed. Damages would be due from the time the lessee knew or reasonably should have known that the offending well was draining his lessor's property. The second benefit lies in freeing the lessor from the necessity of keeping track of a large volume of technical information which he may not have the resources to obtain or decipher and which, quite often, may be unavailable to him. If damages are due only from the time of default, the burden is obviously placed upon all lessors to keep close watch on the reservoir characteristics and production behavior of wells on adjoining property under lease to his own lessee, a burden which seems a bit unfair.

The only further question regarding default is the impact which an express default clause in the lease would have on the type of factual situation under consideration. There are two lines of reasoning which give substantial support to the argument that when the operator has a lease on two adjoining tracts and knowingly continues to drain one of the properties without either unitization or offset operations, even an express default requirement should be inoperative. First, if characterization of this conduct as an active breach of contract is correct, the theory which underlies our Civil Code rules concerning damages indicates that the lessee needs no notice of his transgression;[14] for he has done something inconsistent with his contractual obligations, not merely failed to give timely performance. Thus, an express default requirement could be read as applying only to a mere failure to perform and not to active breaches of contract.

The second source of substantiating logic is in the jurisprudence. The Louisiana Supreme Court has held that when a lessee is aware of an obligation, specifically an obligation to

13. Billeaud Planters, Inc. v. Union Oil Co., 245 F.2d 14 (5th Cir. 1957), noted, 18 LA. L. REV. 354 (1958).

14. For a discussion of this matter see generally Note, 18 LA. L. REV. 354 (1958).

pay royalties, and knowingly and willfully refuses to meet it, neither a judicial ascertainment clause nor a retained acreage clause would be operative.[15] There is at least an analogy to the drainage situation under discussion. If a lessee has actual or constructive knowledge that he is draining his adjoining lease under such circumstances that the reasonably prudent operator would either commence offset operations or form a production unit, it could be said that his failure to take appropriate steps for protection of the adjoining lease while in possession of knowledge of the impact of his conduct represents a willful failure to perform an obligation. Although there might be no suggestion of actual fraud or bad faith in many cases, this analogy does not seem inappropriate under the circumstances.

Some comment should be made concerning the problems of pleading presented by the *Breaux* decision. The lessor contemplating an action for damages should be impressed with the fact that this opinion, if accepted throughout Louisiana's appellate system, requires a very strict compliance with its suggested standards of pleading and proof. The necessary elements for statement of a cause of action for damages for drainage include: the existence of substantial drainage; the quantity of oil or gas that would have been produced from an offset well; the value of lessor's royalty share of such minerals; and proof that it would have been economically feasible for the lessee to drill an offset well — that is, the well would not merely have met operating costs if put into production, but would have "paid out" the investment costs.[16] If the ground for the action is that

15. Bollinger v. Texas Co., 232 La. 637, 95 So. 2d 132 (1957); Melancon v. Texas Co., 230 La. 593, 89 So. 2d 135 (1956). In 5 WILLIAMS & MEYERS, OIL & GAS LAW § 824.2 (1964), it is suggested that the mere fact that a lessee is causing drainage should not dispense with an express requirement of notice of demand prior to commencement of an action for damages. This view may be appropriate in other jurisdictions where damages are due from the time when the lessee knew or should have known of the drainage. However, the concept of default, if utilized in Louisiana as it has been in many instances in the past, imports the consequence that damages become due only from the time of the default. Therefore, if a lessor were limited to damages for drainage occurring only after the default, the right to recover damages might be worth very little. Therefore, it is submitted that Professors Williams and Meyers have made a suggestion which is both erroneous and inappropriate as applied to Louisiana law.

16. Hartman Ranch Co. v. Associated Oil Co., 10 Cal. 2d 232, 73 P.2d 1163 (1937); Renner v. Monsanto Chemical Co., 187 Kan. 158, 354 P.2d 326 (1960); North American Petroleum Co. v. Knight, 321 P.2d 964 (Okla. 1958); Texas Consolidated Oils v. Vann, 208 Okla. 673, 258 P.2d 679 (1953); Hoffman v. Shell Oil Co., 205 Okla. 79, 235 P.2d 696 (1951); Ramsey Petroleum Corp. v. Davis, 184 Okla. 155, 85 P.2d 427 (1938); Chapman v. Sohio Petroleum Co., 297 S.W.2d 885 (Tex. Civ. App. 1956), *error ref'd n.r.e.*

a lessee has failed to establish a drilling unit, the basic elements which would have to be pleaded and proved would include: the existence of substantial drainage; the drainage radius of the well, and thus the amount of the lessor's property which should have been included in a production unit; the amount of drainage; the existence of and failure to utilize means for unitization; and the calculated participation of lessor's property in the minerals already drained. Additionally, if default presents a problem, as it did not in the *Breaux* case, the lessor would be well advised in either instance to plead default or at least a point in time from which it could be said that the lessee actually knew or reasonably should have known of the drainage.

It may be observed that the possibility created by the *Breaux* case of including a duty to unitize within the prudent operator standard seems to strengthen the overlay of ownership concepts added to Louisiana's basic non-ownership property regime, a trend flowing from enforcement of our conservation legislation. If this is true, it does not necessitate alarm or concern, and Louisiana's courts need not balk at implementation of this concept because of ownership connotations. It should be frankly recognized that conservation legislation and technological advance have in combination caused substantial changes in the rights of parties whose property overlies oil and gas reservoirs. The jurisprudence should not reflect an arid affinity for conceptualism in this regard.

Obligation of Further Development

The decision by the Second Circuit Court of Appeal in *Saulters v. Sklar*[17] sustains the existence of the implied obligation to further develop leased premises but properly applies the prudent operator standard to deny partial cancellation of a lease. Plaintiff had purchased a tract of land forming part of a larger area previously subjected to a mineral lease by plaintiff's vendor. A producing well existed on a portion of the lease not owned by plaintiff, unitized by conservation order. Plaintiff's property was included in two units established by a conservation order which were undeveloped at the time of suit. Although defendant lessee had a portion of the acreage included in the undeveloped units under lease, he was not lessee of the

17. 158 So. 2d 460 (La. App. 2d Cir. 1963), *writs denied*, 245 La. 638, 160 So. 2d 227.

area falling within the drill sites designated by the Commissioner of Conservation. Plaintiff made a demand for release of the property or alternatively for reasonable development. Defendant replied that he preferred not to release plaintiff's acreage as it might be utilized for a deep unit. Five months later, plaintiff received a good faith offer of a lease on his property and within a week thereafter filed suit seeking cancellation. The Second Circuit reversed the lower court and rejected plaintiff's demand, finding that there was no evidence that defendant's decision not to attempt any further development in the shallow sands on plaintiff's land was not a reasonable and justifiable decision on the part of the lessees. There was no testimony, either geological or otherwise, that anyone other than plaintiff considered it reasonable or prudent to conduct any further developments. The court seems to have been somewhat influenced by the fact that a well commenced on one of the units including a part of plaintiff's property after commencement of the litigation was abandoned as a dry hole. Certainly this sort of thing, though perhaps not of the highest logical relevance, is a matter of pragmatic concern.

Several aspects of this decision are significant. Obviously, plaintiff was relying heavily on the decision rendered previously by the Second Circuit in *Nunley v. Shell Oil Co.*[18] In that instance, however, defendant lessee had taken the position that no prudent operator would develop the acreage in question as all of its geology disclosed that the acreage would be unproductive. Plaintiff in the *Nunley* case introduced testimony of a bank officer with practical experience in leasing who indicated that he would take a lease on the property in question with a firm drilling commitment. In the *Nunley* case the Second Circuit felt that a lessee should not be allowed to sit on acreage, refusing to further explore the lease on the ground that such development would be fruitless, when plaintiff lessor could secure a lease from an experienced person and obtain early development of his property. In the *Saulters* case, however, the lessee took no such position. His reply to plaintiff's demand for development was, to say the least, highly equivocal, but at least it did not take the position that any efforts to develop would be fruitless.

18. 76 So. 2d 111 (La. App. 2d Cir. 1955).

The *Saulters* decision seems proper and possibly represents one further small step in what appears to have been at least a partial retreat from the *Nunley* decision.[19] However, it would be a mistake to assume that this opinion represents a reversal of *Nunley*. The best interpretation is probably that plaintiff suffered from a failure of proof. In the light of the circumstances of the particular case, the mere presence of a good faith offer to lease was not considered sufficient to show that defendant had not acted as a reasonable and prudent operator.

Another facet of this case warranting comment is that the acreage under lease to defendant was not within the drilling area of the two undeveloped units. This fact should not by itself be relevant to a determination of whether defendant behaved as a prudent operator. The prudent operator standard should, under modern circumstances, include an obligation to do whatever is necessary to effect a unitization or to make operating agreements permitting development of established units in which a lessee has acreage not falling within the drilling area. Of course, if the lessee has made such efforts to unitize or to effect an operating agreement as would have been made by a prudent operator under the circumstances, plaintiff should not prevail in any demand for cancellation. On the other hand, the way should be open for a lessor to show a lack of due diligence in this regard.

19. Romero v. Humble Oil & Refining Co., 93 F. Supp. 117 (E.D. La. 1950), *modified*, 194 F.2d 383 (5th Cir. 1952); Middleton v. California Co., 237 La. 1039, 112 So. 2d 704 (1959). In the *Romero* case lessor had produced an operator who testified that he would be willing to take a lease on the acreage in question with an obligation to drill. The United States Court of Appeals for the Fifth Circuit gave the lessee sixty days in which to satisfy the court that it intended to drill on the premises. If within that sixty days the operator who testified for lessor furnished satisfactory assurances that he would drill, the court stated that the lease would be cancelled with the exception of retained acreage unless defendant lessee satisfied the court within ten days after the operator's assurances that it would further develop the lease. This type of decree has the effect of forcing the *bona fide* offeror of a lease to satisfy the court of the seriousness of his intent, thus avoiding the temptation to an operator to testify as a favor to the lessor without any serious intent to take a lease if the existing lease is cancelled. In the *Middleton* case the record disclosed that the lease in question was of some 4,600 acres. Lessee had operated a number of years and completed forty producing wells. There was ample evidence of a continuous and well co-ordinated drilling and exploration program on the lease. The court refused cancellation on the ground that immediate development of all parts of the lease would be an impossibility. In view of the continuous drilling program, the testimony of a responsible operator willing to undertake a drilling obligation on the untested portions of the lease was not deemed decisive.

Drilling Operations Maintaining Lease

In *Caldwell v. Humble Oil & Refining Co.*[20] defendant lessee was engaged in drilling operations on the date the primary term of its lease expired. Operations were conducted beyond that date, and during their continuance a conservation order was issued including a portion of the leased premises in a production unit. The plaintiff contended the lease had expired, arguing that the clause permitting continuance of drilling operations beyond expiration of the primary term maintained the lease in force only insofar as it granted the right to continue such drilling operations or to engage in further operations within sixty days of abandonment of a dry hole. Although some authority exists in other states under which plaintiff's position could have been sustained, the court took what appears to be the better view, holding that when the lease was maintained beyond its primary term by drilling operations it was maintained in force and effect for all purposes. Therefore, the unitization had the effect of accomplishing production at a time when the lease was still in force. After cessation of the drilling operations the lease was properly held to be maintained by unit production.

Timely Payment of Royalties

Although other issues were involved, the decision in *Fawvor v. United States Oil Co. of Louisiana, Inc.*[21] stands out because it adds another piece to the puzzle concerning timely payment of royalty which began with *Melancon v. Texas Co.*[22] and evolved through *Bailey v. Meadows*[23] and *Pierce v. Atlantic Refining Co.*[24] The *Bailey* and *Pierce* decisions articulated the concept that "failure to pay production royalties under an oil and gas lease for any appreciable length of time, without justification, amounts to an active breach of such lease which entitles the lessor to a cancellation thereof without the necessity of placing the lessee in formal default."[25] The emergence of this general rule has been ably discussed in a previously published student

20. 155 So. 2d 228 (La. App. 2d Cir. 1963).
21. 162 So. 2d 602 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 575, 165 So. 2d 479.
22. 230 La. 593, 89 So. 2d 135 (1956).
23. 130 So. 2d 501 (La. App. 2d Cir. 1961).
24. 140 So. 2d 19 (La. App. 3d Cir. 1962).
25. Pierce v. Atlantic Ref. Co., 140 So. 2d 19, 29 (La. App. 3d Cir. 1962); Bailey v. Meadows, 130 So. 2d 501, 508 (La. App. 2d Cir. 1961).

comment.[26] It was there noted that the *Fawvor* decision supports the conclusion that the appellate courts will examine the facts and circumstances of each case involving alleged unjustifiable delay in commencing payment of production royalties rather than stating general rules based upon lapse of time. It may be pointed out that in *Pierce v. Atlantic Refining Co.*,[27] the delay involved was approximately six months. In the *Fawvor* case, however, the delay was eight months; yet cancellation was denied.

The *Fawvor* record disclosed that the delay was occasioned partially by obtaining surveys and title examinations of the area included within the unit. This delay initially consumed approximately three of the eight months in question. At that time lessors took the position that the lease had terminated automatically for failure to pay delay rentals. This position is, of course, inconsistent with any demand for payment of royalties, and any attempt at payment would have been no more than a formality. However, approximately eight months after establishment of the production unit defendant lessee did begin issuance of royalty checks which were received and retained by lessors each month.

Under the circumstances the decision that the delay of eight months in commencing payment of royalties was not unjustified is clearly correct. The salient factual element in this case is the lessors' assumption of the position that the lease had terminated automatically for failure to pay delay rentals. The importance of this fact was underscored in a concurring opinion by Judge Tate, who emphasized that although a substantial portion of the eight-month delay was excusable because of the necessity for performing all of the administrative tasks necessary to compute royalty participation in the unit, the delay might not have been excusable but for the lessors' contention that the lease had terminated for failure to pay delay rentals. This analysis appears to be the correct one, for if the lessors had not informed lessee of their position that the lease had terminated, the facts of the case would have been very nearly indistinguishable from those in *Pierce v. Atlantic Refining Co.*[28]

The *Fawvor* decision is a welcome amelioration or elabora-

26. Comment, 24 LA. L. REV. 618 (1964).
27. 140 So. 2d 19 (La. App. 3d Cir. 1962).
28. *Ibid.*

tion of the *Bailey-Pierce* concept. Though the writer recognizes the basic elements of merit in the attitude which inspired the emergence of this concept, its utterance has nevertheless sparked a great revival of the game of "lease snatching" by lessors in Louisiana. Despite the fact that some sanction should be applied when a lessee willfully, arbitrarily, or negligently fails to commence payment of production royalties for an unreasonably extended period of time, the remedy of cancellation is certainly harsh in view of the high level of investment by lessees in achieving production. It is additionally harsh in these cases because the principle as evolved permits complete cancellation.[29] It is, perhaps, the prospect of this remedy which has spurred lessors to hover like carrion crows over the administration of leases when production is first established, hungrily awaiting the fatal error. Perhaps the *Fawvor* decision will dim the general enthusiasm for this practice.

Pooling Clauses

Certainly the decision in *Humble Oil & Refining Co. v. Jones*[30] is one of the most significant in recent years. Although this case has been ably noted in an earlier edition of this *Review*,[31] its importance requires that it at least be mentioned. On the second trip to the top of the Louisiana court system,[32] the definitive opinion was written by the Third Circuit Court of Appeal. Writs were denied by the Supreme Court.[33] Without considering the conflict within the court over the question whether the particular unit in question was a "contractual" or a "declared" unit, one can draw certain conclusions concerning the law governing unitization and the life of different types of units in Louisiana. First, in the case of a declared unit, with which the court found it was dealing in the *Jones* case, the normal pooling clause in use today grants the lessee authority to

29. See the decrees in Pierce v. Atlantic Ref. Co., 140 So. 2d 19 (La. App. 3d Cir. 1962) and Bailey v. Meadows, 130 So. 2d 501 (La. App. 2d Cir. 1961).

30. 157 So. 2d 110 (La. App. 3d Cir. 1963), *writs denied*, 245 La. 568, 159 So. 2d 284 (1964).

31. Note, 24 LA. L. REV. 935 (1964).

32. The case had previously been decided by the Third Circuit Court of Appeal, Humble Oil & Refining Co. v. Jones, 125 So. 2d 640 (La. App. 3d Cir. 1960). However, the case was remanded on procedural grounds by the Louisiana Supreme Court, Humble Oil and Refining Co. v. Jones, 241 La. 661, 130 So. 2d 408 (1961). The original opinion by the Third Circuit is essential to an understanding of the final opinion, which essentially confirms the original.

33. Humble Oil & Refining Co. v. Jones, 245 La. 568, 159 So. 2d 284 (1964).

declare a unit essentially for purposes of conservation. Upon issuance of a conservation order defining the drainage area of a unit well and establishing a unit with different geographical outlines from that of a previously declared unit, the declared unit is terminated or resolved as it no longer has any substantial conservation purpose.

The court seems to be on firm ground in adopting the attitude that "parties should not be presumed to have agreed to share their interests on the old declared unit unless they show a specific and positive intention to freeze the old unit."[34] This decision does nothing to destroy the flexibility of contractual devices as parties could agree to permit unitization in such manner as to "freeze" participation. However, in the absence of an express intent to do so, it is proper to refuse to find any such implied intent, particularly when the lease defines the reasons for which units may be declared and limits the pooling power to conservation purposes.

The second conclusion is that if the court had been dealing with what it termed a "contractual unit" — that is, one formed by an agreement to which all parties in interest are signatory — the interests of the participating parties might have been frozen.[35] While this is probably a correct interpretation of the average unitization agreement, it is dangerous to place labels on units in the abstract. Just as it is possible that a pooling clause might permit a lessee to freeze a given lessor's interest in a declared unit, it would also be possible for parties to a contractual unit to agree that later formation of a conservation unit would dissolve the contractually created unit. However, the court seems to adopt the view that in the case of a contractual unit, the situation of the parties and the fact of entry into the agreement by *all* interested parties warrant the inference of an implied intent to freeze participating interests. Although the writer has some reservation about implication of intent to freeze participating interests generally, this is not an unsound approach in most instances.

Thus, it seems that there is an emerging tendency to require an express intent to freeze an interest in a declared unit under

34. Humble Oil & Refining Co. v. Jones, 125 So. 2d 640, 646 (La. App. 3d Cir. 1960).

35. In addition to the principal case, see Texaco, Inc. v. Vermilion Parish School Board, 145 So. 2d 383 (La. App. 3d Cir. 1962).

the standard pooling clause and to infer such an implied intent in the typical contractual unit. Accepting the *caveat* that one should be careful in attaching labels to agreements which are still flexible and subject to alteration by contracting parties, these rules offer a satisfactory guide to persons concerned with unitization problems.

One further observation should be made concerning the *Jones* case. There is language in the majority opinion suggesting that the declared unit was "superseded" by the conservation unit because of an inherent conflict between the two.[36] This is a very fuzzy thought. Situations of this kind do not present problems of conflict between the effectiveness of the conservation laws and private agreements. The purposes for which the conservation unit were formed can be fully achieved without the necessity of dissolving an existing voluntary unit, which could be viewed simply as a sharing arrangement between the interested parties. The truth of this statement is borne out by the Third Circuit's own reasoning regarding "contractual" units. The court's view is that a contractual unit would not be dissolved by a subsequently formed conservation unit and that parties would continue to share in production according to the terms of their contractual agreement.[37] If a contractual unit can exist without burden or conflict with the conservation scheme, there is no reason whatsoever why a declared unit cannot continue to exist if the agreements involved are susceptible of an interpretation that the parties intended such a result.

This problem of conflict between conservation orders and property and contractual rights is an increasingly complex one and bears discussion in a more extended but separate article.[38] It is sufficient here to state that the Louisiana courts show an increasing tendency to find conflicts between private agreements or property rights and the conservation scheme when no such conflict actually exists. There is a strong suspicion that this attitude cloaks a public policy favoring some divisive effect which fosters a partial return of mineral rights to the landowner.

36. Humble Oil & Refining Co. v. Jones, 125 So. 2d 640, 648 (La. App. 3d Cir. 1960).

37. See note 34 *supra*.

38. For a discussion of another aspect of this subject see the discussion under topic "Mineral Royalty" *infra*.

Subleases

In *Texas Gulf Producing Co. v. Gulf Coast Drilling & Exploration Co.*,[39] plaintiff sublessor sued its sublessee for damages for failure to maintain an oil and gas lease in force in accordance with their sublease agreement. The original lease taken by plaintiff and sublet in part to defendant contained a "Pugh clause"; as part of the acreage covered by the lease had been included in a conservation unit, rentals were due on the outside acreage. It appeared that plaintiff had advised defendant of the method to be utilized in computing the rentals on the outside acreage and had for two years made such payments for defendant's account. The amount of acreage from the lease included in the conservation unit was reduced by reformation of the unit, thus increasing the rental payments due. The third rental payment was made by plaintiff but without correction for reduction of the unit. The original lessor immediately advised plaintiff of the error, and apparently employees of plaintiff received notice of the lessor's objection on the day on which rental was due. Defendant answered plaintiff's petition and reconvened, contending that the lapse of the lease resulted from actions for which plaintiff was solely responsible. The district court granted defendant's motion for summary judgment and also rejected defendant's reconventional demand.

It was obvious to the court that plaintiff sublessor, having retained an interest in the lease, having undertaken to pay the delay rentals on the subleased tracts, and having had knowledge of the conservation order reducing the lease acreage included in the unit, was in no position to fix responsibility for the underpayment on defendant. Similarly the defendant had no right to recover damages from plaintiff. The decision seems to rest upon the notion that although defendant was contractually burdened with responsibility for rental payments on the subleased acreage, plaintiff's participation in making the rental payment and computing the amounts to be paid constituted a pattern of conduct between the parties in administering the contract which made the obligation of making rental payments a joint responsibility of sublessor and sublessee. Thus, participation in the making of payments and knowledge of the facts which would have permitted proper payment by both parties prohibited each from fixing legal responsibility on the other.

39. 154 So. 2d 559 (La. App. 1st Cir. 1963).

MINERAL ROYALTY

The decision of the Third Circuit Court of Appeal in *Montie v. Sabine Royalty Co.*[40] further elaborates the decision rendered in *Crown Central Petroleum Corp. v. Barousse*[41] concerning the effect of production from a voluntary unit on prescription of a mineral royalty. The importance of this case warrants its discussion jointly with *Frey v. Miller*,[42] which, strictly speaking, is not due for discussion until next year's symposium.

In the *Montie* case, plaintiff landowners sought cancellation of a mineral royalty owned by defendant on a 368 acre tract of land insofar as the royalty affected acreage not included in a producing unit. The unit in question was established by declaration under a lease granted by the landowners and included only 9.624 of the 368 acres subject to the royalty. There was never any pooling agreement or other contract regarding the unit signed by both the royalty owner and the landowner. Therefore, there was no basis for finding any intent to divide the royalty.

However, the landowners contended that as the instrument creating the mineral royalty in question had specifically authorized the execution of leases on the property by landowners and further as the lease contained a "Pugh clause," this should have the effect of dividing the royalty interest. If this contention had been sustained, the interest would have been preserved only in the acreage included within the unit. The Third Circuit quite correctly refused to give the Pugh clause in the lease executed by the landowners any such effect. To do so would have given the landowner unilateral power to divide the mineral royalty by the execution of a contractual agreement. Certainly no such power should be found unless expressly stated in a conveyance.

The *Montie* case is most interesting in juxtaposition with *Frey v. Miller*,[43] in which the effect of a conservation unit on a royalty interest was considered. The factual situations were similar in that in *Frey* the unit included only a part of the tract subject to the royalty interest. Therefore, the only basic dis-

40. 161 So. 2d 118 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 84, 163 So. 2d 359.
41. 238 La. 1013, 117 So. 2d 575 (1960).
42. 165 So. 2d 43 (La. App. 3d Cir. 1964), *writs denied*, 246 La. 844, 167 So. 2d 669.
43. *Ibid.*

tinction between the two cases is that one unit was established by declaration and the other by compulsory order of the Commissioner of Conservation. On rehearing, the Third Circuit reversed its original opinion and held that the conservation order had a divisive effect on the royalty interest, which was, therefore, preserved by production from the unit well only on acreage included therein. The court felt itself bound by the decisions of the Supreme Court regarding mineral servitudes in *Childs v. Washington*[44] and *Jumonville Pipe & Machinery v. Federal Land Bank.*[45]

While the Third Circuit's action in following the Supreme Court jurisprudence with regard to servitudes may be justifiable on the ground of the Supreme Court precedents and also on the ground that in dictum in *Crown Central Petroleum Corp. v. Barousse*[46] the Supreme Court intimated that the *Childs* and *Jumonville* decisions would be applicable to mineral royalties, the *Frey* and *Montie* decisions point up the fallacious reasoning which affects this entire area of the Louisiana jurisprudence. In both of these cases there is no contractual agreement from which any intent to divide the royalty interest could have been implied. The only distinction is the difference in methods by which the units were established. This fact leads one to consider whether this distinction may not be arbitrary, and in that regard whether it might not even afford some basis for contending that there is a denial of equal protection of the law in the differing treatment of the two situations.

This symposium is not an appropriate forum for an extended discussion of the jurisprudence in this area. It is noteworthy, however, that a principal legalistic basis for the distinction between these two cases is that in one there is a supposed "conflict" between conservation laws and private property rights or agreements.[47] Therefore, it is asserted, the latter must yield. This is an unreal view. There is no conflict whatsoever between private property rights in this instance and the conservation order. The ends of conservation are served regardless whether

44. 229 La. 869, 87 So. 2d 111 (1956).
45. 230 La. 41, 87 So. 2d 721 (1956).
46. 238 La. 1013, 117 So. 2d 575 (1960).
47. This fallacious assumption was observed and discussed by Chief Justice Fournet in dissenting from the denial of writs in Frey v. Miller, 246 La. 844, 167 So. 2d 669 (1964).

the interruption extends only to the acreage included in the unit or to all the acreage subject to the servitude or mineral royalty.

This unrealistic rationalization of the cases involving units established by conservation order actually seems to be no more than a cloak for a policy attitude on the part of the courts. There seems to be a strong feeling that, if a servitude owner or royalty owner is to receive the benefit of an interruption of prescription resulting from operations off the servitude or royalty premises, the effect of such use should be limited. The validity of this policy can be argued freely and with ample support on either side. However, one cannot help observing that there is no basis for making the arbitrary distinction which appears from the *Montie* and *Frey* decisions. If the Supreme Court determines that its policy is to limit the effect of an off-premises use, this policy should be applied in a nondiscriminatory manner. The whole idea that conservation orders have some automatic divisive effects on servitudes or royalties in these situations seems questionable: in neither instance is there any proper basis for inferring an intent that conservation orders should have this effect when the parties to a conveyance have been completely silent on the matter. The writer proposes to subject this problem to a more extended discussion at a later date. It was hoped that the Supreme Court would have considered these two cases as they bring the problem of the impact of conservation orders on servitude and royalty rights sharply into focus. It is suggested that either a more straightforward approach to the public policy problem should be adopted, or the notion that conservation orders have automatic divisive effects should be abandoned.

PUBLIC LANDS

Lewis v. State[48] is a satisfying breath of fresh air after the recent decisions tending to favor circumvention of the constitutional prohibition against alienation of mineral rights by the State of Louisiana.[49] Plaintiff's ancestors in title held under a 1943 patent issued in satisfaction of a lieu warrant of 1942. The 1942 lieu warrant was issued in substitution of a warrant granted in 1862 after discovery that the state had no title to the land described in the original warrant. The 1943 patent contains no express reservation of mineral rights. Plaintiff contended that

48. 244 La. 1039, 156 So. 2d 431 (1963).
49. Stokes v. Harrison, 238 La. 343, 115 So. 2d 373 (1959); King v. Board of

article IV, section 2, of the Louisiana Constitution[50] requiring reservation of mineral rights in property sold by the state was inapplicable because prior rights had accrued under the 1862 patent. Plaintiff also contended that the state could not make a collateral attack on the patent and pleaded the six-year prescription under R.S. 9:5661 (Act 62 of 1912).[51] The Supreme Court, however, rejected plaintiff's demands.

Distinguishing the case at bar from earlier decisions in which applications for lieu warrants were made prior to 1921, the court held that article IV, section 2, of the Constitution was applicable as no action of any kind was taken by the holders of the defective patent until 1942. Thus, the conveyance took place after 1921. The court found no exclusionary language in the 1921 constitutional provision which would permit the interpretation demanded by plaintiff. It also rejected the argument that the state was making a collateral attack on the patent, observing that the titles of both plaintiff and the state were at issue.

Further, the six-year prescription under R.S. 9:5661 was held inapplicable. It was stated that the prescriptive statute "must yield to the Constitution of 1921, which embodies the clearly stated public policy that mineral rights in all land sold by the state must be reserved. The state cannot lose by prescription that which it cannot constitutionally alienate."

OTHER CASES

A number of other cases were decided during the past term. However, discussion of these is omitted for any one of several reasons: some have been noted in this issue or in previous issues;[52] others are of no great significance in terms of their con-

Commissioners for Atchafalaya Basin Levee District, 148 So. 2d 138 (La. App. 3d Cir. 1962), *writs denied*, 244 La. 118, 150 So. 2d 585 (1963), noted 24 LA. L. REV. 416 (1964).

50. LA. CONST. art. IV, § 2: "In all cases the mineral rights on any and all property sold by the State shall be reserved, except where the owner or other person having the right to redeem may buy or redeem property sold or adjudicated to the State for taxes."

51. LA. R.S. 9:5661 (1950): "Actions, including those by the State of Louisiana, to annul any patent issued by the State, duly signed by the Governor and the Register of the state land office and of record in the State Land Office, are prescribed by six years, reckoning from the day of the issuance of the patent."

52. Little v. Haik, 246 La. 121, 163 So. 2d 558 (1964) is cited and Hayes v. Muller, 245 La. 356, 158 So. 2d 191 (1963) is the principal case in the note appearing in 25 LA. L. REV. 277 (1964). Landry v. Flaitz, 245 La. 223, 157 So. 2d 892 (1963), was discussed in last year's symposium, *The Work of the Louisiana Appellate Courts for the 1962-63 Term — Mineral Rights*, 24 LA. L. REV. 215, 221-23 (1964).

tribution to the emergence of Louisiana mineral law;[53] and still others, though involving mineral contracts, do not turn on points of mineral law.[54]

INSURANCE

*J. Denson Smith**

Policies of insurance continued as a fruitful source of litigation in the appellate courts during the 1963-64 term. The Insurance Code, with a view to encouraging prompt payment of claims, contains a number of provisions permitting the recovery of penalties and attorneys' fees for delay in payment. These provisions tend to minimize litigation. On the other hand, the well-settled and justifiable rule that the insurance contract, if ambiguous, is to be construed against the insurer and liberally in favor of the insured has a tendency to encourage litigation. On the whole, the decisions rendered by the courts demonstrate a creditable restraint in the application of both of these rules. Most of the cases in this area turned on factual issues not justifying discussion, yet a fair number were sufficiently significant to bear noting.

AUTOMOBILE LIABILITY

The family combination automobile policy continues to give rise to the greatest amount of litigation. A particularly well-written opinion in this area is the case of *Smith v. Insurance Co. of the State of Pennsylvania.*[1] It contains an exhaustive review of the cases dealing with the troublesome problem of coverage for the benefit of permittees. The court held a regulation of the Department of Public Safety forbidding the use of state-

53. Scott v. Hunt Oil Co., 160 So. 2d 433 (La. App. 2d Cir. 1964), *writs denied*, 245 La. 950, 162 So. 2d 8; Scott v. Ware, 160 So. 2d 237 (La. App. 2d Cir. 1964); State *ex rel.* Bordelon v. Justice, 160 So. 2d 844 (La. App. 4th Cir. 1964), *writs denied*, 245 La. 1084, 162 So. 2d 574; Menefee v. Pipes, 159 So. 2d 439 (La. App. 2d Cir. 1964), *writs denied*, 245 La. 798, 161 So. 2d 276; Armour v. Smith, 158 So. 2d 446 (La. App. 2d Cir. 1963), *writs granted*, 245 La. 637, 160 So. 2d 227 (1964); Birdsong-Gabriel Oil Co. v. McCain, 154 So. 2d 216 (La. App. 2d Cir. 1963).

54. Martin Timber Co. v. Roy, 244 La. 1050, 156 So. 2d 435 (1963); Johnson v. Lemons, 157 So. 2d 752 (La. App. 2d Cir. 1963).

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1. 161 So. 2d 903 (La. App. 1st Cir. 1964).